

Decision **PROPOSED DECISION OF ALJ MCVICAR (Mailed 6/16/2005)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Gabriel Valley Water Company (U337W) for Authority to Increase Rates Charged for Water Service in its Los Angeles County Division by \$11,010,200 or 29.3% in July 2005, \$1,590,100 or 3.3% in July 2006, and \$1,798,600 or 3.6% in July 2007.

Application 04-09-005
(Filed September 1, 2004)

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Daniel Dell'Osa, for San Gabriel Valley Water Company, applicant.
Cleveland Lee, Attorney at Law, and Victor Chan, for the Commission's
Office of Ratepayer Advocates, protestant.

OPINION GRANTING GENERAL RATE INCREASE

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OPINION GRANTING GENERAL RATE INCREASE**Summary**

This decision approves a \$4,110,200 (10.9%) general rate increase for San Gabriel Valley Water Company, Los Angeles County Division, for fiscal test year 2005/2006.¹ Based on current escalation factors, the adopted 2005/2006 summary of earnings figures, adopted rate base for 2006/2007, and the authorized rate of return established in this decision, the rate changes for the second and third years, escalation years 2006/2007 and 2007/2008, are currently estimated to be increases of \$516,600 (1.2%) and \$416,800 (1.0%) respectively. The actual rate adjustments for the second and third years will not be determined until advice letters for those years are filed and evaluated in May 2006 and May 2007 using the most recent escalation factors available at that time. In addition, San Gabriel may file advice letters to: offset the salaries and pension and benefit costs of two new employees; offset the costs of certain plant additions when they are completed in years two and three; amortize the balance in its water quality litigation memorandum account associated with its defense of water quality litigation; and amortize the amounts recorded in its purchased water, pumped water, and purchased power balancing accounts. San Gabriel is also ordered to credit to its water quality litigation memorandum account \$3.5 million it is receiving in excess of its capital and operating costs of remediation facilities in a pollution litigation settlement. This proceeding is closed.

¹ The test and escalation years in this proceeding are fiscal years beginning July 1 and ending June 30.

Background

San Gabriel Valley Water Company (San Gabriel) provides public utility water service through its Los Angeles County Division (LA Division) to approximately 47,000 customers in the County of Los Angeles and the Cities of Arcadia, Baldwin Park, El Monte, Industry, Irwindale, La Puente, Montebello, Monterey Park, Pico Rivera, Rosemead, San Gabriel, Santa Fe Springs, South El Monte, West Covina, and Wittier. San Gabriel serves another 40,000 customers in San Bernardino County through its Fontana Water Company Division (Fontana Division). This general rate case involves only the LA Division and its general office serving both divisions.

San Gabriel filed the application on September 1, 2004, and the Commission in Resolution ALJ 176-3139 preliminarily determined this to be a ratesetting proceeding expected to go to hearing. Assigned Administrative Law Judge (ALJ) James McVicar held a prehearing conference on November 1, 2004. Assigned Commissioner Michael Peevey's November 5, 2004 scoping ruling confirmed the category and need for hearing, defined the issues, established a schedule, and designated ALJ McVicar as the principal hearing officer and thus the presiding officer.

ALJ McVicar conducted two days of evidentiary hearing in Los Angeles on January 19 and 20, 2004, and a public participation hearing the evening of January 20 in La Puente. The proceeding was submitted on receipt of closing briefs on March 21, 2004 following two extensions, the first sought jointly by both parties, the second requested by the Commission's Office of Ratepayer Advocates (ORA) and agreed to by San Gabriel.

San Gabriel's application requests the rate increases shown in Table 1 to counter the effects of substantial increases in major expense items and plant investment. Of the five most significant issues the application identifies as driving San Gabriel's rate increase request, increased rate of return is by far the largest. The others are two well and reservoir projects, a water treatment project, and a new office building. In addition, San Gabriel seeks Commission approval to modify, and/or amortize balances in various balancing and memorandum accounts. The rate effects of those additional requests are not included in the Table 1 figures.

Table 1
Requested vs. Adopted Increases

	Application Requested		Adopted	
	\$	%	\$	%
Test Year 2005/2006	\$11,010,200	29.3%	\$4,110,200	10.9%
Escalation Year 2006/2007	\$1,590,100	3.3%	\$ 516,600	1.2%
Escalation Year 2007/2008	\$1,798,600	3.6%	\$ 416,800	1.0%

Notes: (1) Adopted increase shown for 2005/2006. For 2006/2007 and 2007/2008, increases shown as adopted are only estimates based on April 2005 escalation factors. (2) Application Requested column includes the rate effects of 16 major plant addition projects not reflected in the adopted figures.

San Gabriel prepared its request using an 12.00% return on common equity, which it estimated would produce an 11.17% rate of return on rate base each year of the three-year rate case cycle.

Discussion

The Parties' Agreement

During the evidentiary hearings, the parties indicated that they had been meeting to review their differences and had arrived at tentative agreements on

many topics previously at issue in their prepared testimony. Each presented witnesses and statements by counsel briefly confirming and describing those tentative agreements. The ALJ directed the parties to file with their opening briefs the joint comparison exhibit called for in the new rate case plan,² and the parties indicated they would also include with it a full description of the topics on which they had reached agreement. They subsequently filed it with the title, “All Parties Joint Stipulations and Comparison Exhibit” (Agreement, and Comparison Exhibit). However, the parties neither formally moved adoption of their Agreement nor provided a joint statement of factual and legal considerations underlying it, both required elements for “stipulations” as defined in the Commission’s Rules of Practice and Procedure, Rule 51.1.³ There is, in fact, no indication in the record that the resulting joint recommendations are the result of compromise. Rather, they appear to be revised, shared recommendations arrived at jointly as a result of each party’s having re-examined its earlier

² “The applicant and ORA shall prepare and submit a Joint Comparison Exhibit showing complete comparison tables for the test and escalation years. The tables shall show each party’s final position on each component of revenue requirement and shall identify all remaining major disputed issues, and the dollar amounts associated with each disputed issue. All major revisions to a party’s position on an issue shall be explained.” (Rate Case Plan (RCP) for Class A Water Utilities, Decision (D.) 04-06-018, Appendix page 15). The joint San Gabriel and ORA filing does provide tables comparing their final positions on each component of revenue requirement, but the only comprehensive identification and discussion of the remaining major, disputed issues and the parties’ positions on them was that provided in San Gabriel’s opening brief.

³ “Parties may by written motion propose stipulations or settlements for adoption by the Commission in accordance with this article. The motion shall contain a statement of the factual and legal considerations adequate to advise the Commission and parties not expressly joining the agreement of its scope and of the grounds on which adoption is urged.” (Rule 51.1, Proposal of Settlements or Stipulations.)

conclusions in light of evidence presented by the other. Thus, we treat them here as issue-by-issue joint recommendations rather than stipulations under Rule 51 *et seq.*

The All Parties Joint Stipulations and Comparison Exhibit, filed with opening briefs on March 16, 2005, is Attachment E to this decision. After considering the evidence presented, we find each of the parties' agreed-upon outcomes reasonable and adopt them, except as otherwise discussed below.

Summary of Earnings

In this section we discuss the parties' differences over line items in the summary of earnings as set forth in the Comparison Exhibit. The results are shown in Attachment A, Adopted Summary of Earnings.

Operating Revenues

San Gabriel and ORA agree on the method to be used to compute revenue in the test year. The parties initially presented differing estimates for the figures underlying their revenue calculations. ORA generally showed slightly higher numbers of customers by customer class and slightly higher consumption per customer, leading to higher sales and revenue forecasts and thus lower rates. After further review and discussion, both agreed to use San Gabriel's forecast of average numbers of customers for all customers classes, San Gabriel's annual average usage per customer for residential and large public authority customers, and ORA's annual average usage per customer for large and small industrial and small public authority customers. Numbers of customers and sales per customer are drivers for estimates of water production and purchased power; both were adjusted accordingly. We adopt the parties' results for our revenue and other calculations.

Operating Expenses

The Comparison Exhibit shows no difference in the parties' estimates of the following operating expense categories for test year 2005/2006:

- Purchased Water
- Purchased Power
- Chemicals
- Materials and Supplies
- Other Operating and Maintenance Expenses
- Administrative Expense Transferred
- Bank Charges
- Payroll Taxes

We discuss below those other operating expense categories still showing differences.

Payroll Expense

Differences between San Gabriel's and ORA's initial payroll estimates for both LA Division and general office can be attributed to four main factors: The recorded base period chosen, adjustments made to the recorded base period amounts, escalation rates applied to bring the adjusted recorded base period amounts forward to the test year, and allowances for new positions. We examine the last factor first.

San Gabriel initially requested payroll expense allowances for seven new positions, and ORA proposed disallowing all seven.⁴ After further discussions,

⁴ The parties agree that one other position, a "Rate Analyst," was filled in 2003 and included in the 2003 recorded figures, but ORA initially disallowed it in the belief that San Gabriel had not followed the advice letter procedure for it authorized in D.04-07-034, San Gabriel's Fontana Division general rate case decision. The parties now

Footnote continued on next page

the parties have agreed to the following outcomes. Positions of “Rate Analyst” (in the general office) and “Plant Maintenance Man ‘A’” (in LA Division) have already been filled and should be included in test year rates. San Gabriel withdraws its requests for a “Regulatory Compliance Coordinator” (general office) and “GIS Specialist” (LA Division). They jointly recommend for the remaining four new positions, “Assistant Purchasing Agent” and “Assistant Engineer” (both in general office), and “Water Quality Specialist” and “Water Treatment Operator III” (both in LA Division), that San Gabriel be authorized to recover the salaries plus associated pensions and benefits through an advice letter filing when the positions are filled.

We agree with these outcomes, but impose two qualifications. San Gabriel estimates that it will recover approximately 20% and 75%, respectively, of the cost of the latter two positions through lawsuits against polluters, and the Agreement requires San Gabriel to reduce its request by San Gabriel’s best estimate of those amounts at the time an offset advice letter is filed. We prefer the certainty of fixing those percentages today based on San Gabriel’s current best estimates to having San Gabriel re-estimate them later and imposing on Water Division the burden of checking San Gabriel’s estimates. Thus, San Gabriel may recover by advice letter(s) 80% and 25% respectively of the salaries and associated pension and benefit costs of one new Water Quality Specialist position and one new Water Treatment Operator III position in LA Division after each of those positions are filled. These adjustments should continue to be used for ratesetting until new levels are established in San Gabriel’s next LA Division

agree that the requisite advice letter was filed in November 2004 and the position was approved effective January 1, 2005.

general rate case. And, as we discuss in the Rate Base section of this order, we prefer to limit the number of offset advice letter increase filings San Gabriel will make, so we will include the Water Quality Specialist and Water Treatment Operator III offset filings in the two advice letters per year restriction we impose for rate base offset filings below.

ORA based its payroll forecast on payroll expense for recorded year 2003 and escalated to test year 2005/2006 by applying the labor inflation rates specified in Energy Cost of Service Branch's (ECSB) September 30, 2004 memorandum. San Gabriel used actual June 2004 compensation rates for all authorized positions including those that were temporarily vacant, escalated to the test year using a compensation per hour index specified in a second ECSB memorandum, and adjusted by a factor reflecting routine biennial step increases for entry level positions.⁵ San Gabriel points out several computational errors in ORA's method. San Gabriel charges that ORA first subtracted from the 2003 recorded payroll figures the salary costs for three of the positions ORA initially disallowed, and then escalated to the test year. That should not be done unless those positions were already filled and their costs actually in the recorded data. They were not, and ORA did not respond to the charge. San Gabriel also charges ORA with two other computational errors that appear to have produced higher estimates, to San Gabriel's advantage. Again, ORA did not respond.

We also see three problems with San Gabriel's proposed estimating method. First, when payroll costs are brought forward, no adjustment should be made for temporary vacancies absent a showing of extraordinary circumstances. Most utilities will at some point have position vacancies caused by, *e.g.*,

⁵ San Gabriel Opening Brief, page 11.

separations, retirements, or intentionally holding a position open for cost savings. To the extent there were vacancies in the recorded year, we should assume there will also be comparable vacancy savings in the test and escalation years. Second, an analogous observation applies to bolstering recorded payroll expenditures by adding, as San Gabriel did, “routine biennial step increases for entry level positions.” There has been no showing that the test year and escalation years will have an atypically high level of entry level step increases compared to the recorded base year, or that the base recorded year had an unusually low number, nor has an offsetting adjustment been considered for the possible effects of higher paid senior employees “topping out” in the salary brackets or for savings due to their departure. Again, absent such a showing, San Gabriel’s base year adjustment is rejected. Third, ECSB’s compensation per hour is applicable to contracted services, not employee labor. ECSB provides different recommended wage inflation rates specifically for escalating utility labor figures.⁶ The new RCP requires ECSB’s labor inflation rates be used for the escalation years, and, again absent a showing of extraordinary circumstances, we favor those inflation rates for bringing recorded figures forward as well. We will use the ORA payroll estimating method summarized above for both general office and LA Division, first correcting for the errors San Gabriel points out.

⁶ Exhibit ORA-1, Attachment A.

Transportation Expense

The Comparison Exhibit shows a minor difference (\$700, about 0.14%) in transportation expense that neither party has explained. Based on a statement of San Gabriel's counsel at the evidentiary hearing that overall agreement had been reached,⁷ and Section 8.1 of the Agreement, we adopt San Gabriel's estimate.

Employee Pensions & Benefits

ORA and San Gabriel used very different methods to estimate employee pension and benefit expenses. ORA began with recorded pension and benefit figures for 2003, the most recent available, and inflated them to the 2005/2006 level.⁸ From this, it subtracted amounts corresponding to the new positions San Gabriel proposed to add, and submitted the result as its initial estimate. San Gabriel criticized ORA's method for, among other things, deducting pensions and benefits associated with the new positions even though those new positions were not reflected in the recorded expenses to begin with; applying non-labor escalation rates in a manner inconsistent with guidance given in the ECSB memo; ignoring San Gabriel's substantial workforce growth since 1999; and ignoring a rapid increase in medical and dental insurance costs in recent years. San Gabriel also began with 2003 recorded expenses, but separated out and projected insurance benefits (health, dental, life, and long-term disability coverages) using annual percentage increases. For health insurance, San Gabriel used known 2004 premium rate increases, projections of new employees becoming eligible for insurance, projected rates of increase for the two main

⁷ RT 5.

⁸ According to San Gabriel's witness, ORA was inconsistent in that it used a different, five-year averaging method for its general office pensions and benefits estimate.

insurance carriers in 2005 and 2006, and the expected effect of new legislation requiring expanded employer-provided health care. San Gabriel later removed the effects of the new legislation when it was dropped, and both parties revised their estimates as a result of the agreement reached on new employee positions.

Neither party's showing inspires confidence. ORA's calculations do appear to be, as San Gabriel charges, logically flawed with respect to new positions and employee growth, and inconsistent as between LA Division and general office. San Gabriel's method appears to be rational and supportable, but the record does not reflect the specific escalation factors it claims to have used, so we cannot easily evaluate them. We note, however, that San Gabriel's result, as revised for the parties' Comparison Exhibit, represents an approximate 11% annual increase from recorded 2003 to test year 2005/2006.⁹ While this is higher than the 7.4% annual growth from 1999 to 2003, it is not unreasonably so considering what we have come to expect in health care costs (which make up a large part of the account) in recent years. We will adopt San Gabriel's revised pensions and benefits estimates.

Uncollectibles and Franchise Fees

ORA agrees with San Gabriel's proposed uncollectibles and franchise fee factors. The differences shown in the Comparison Exhibit are due to differences in other areas.

⁹ Figures derived from Exhibit SG-2, Tables 6A and 6B, and Comparison Exhibit.

Outside Services

San Gabriel's initial estimates were based on its recorded 2003 expense levels, adjusted in part to reflect physical plant increases since 2003, and escalated to the test year using ECSB's compensation per hour factors. According to San Gabriel (ORA's presentation is unclear on this point), ORA used a five-year average of recorded expenses through 2003 and brought it forward using ECSB's labor escalation factor. San Gabriel faults ORA for not recognizing that outside services costs, which include operation, maintenance, and administrative and general services provided by non-utility third parties, are in some subaccounts expenses which vary directly with the quantities of physical plant. There is a reasonable question as to whether for bringing recorded amounts forward the parties should apply a CPI-U factor (as D.04-06-018, the RCP decision, calls for when doing escalation year estimates) or a compensation per hour factor (as ECSB's memo directs, for contracted labor). Neither, however, calls for using ECSB's labor factors as ORA did. The greater part of the parties' initial estimating difference was later eliminated as a result of their joint recommendation on the cost of maintaining emergency generators.¹⁰ Considering that ORA did not clearly describe its method, that it may have used an inappropriate factor to bring recorded expenses forward, and that it did not make allowances for increasing plant levels, we will adopt San Gabriel's outside services estimate for test year 2005/2006.

¹⁰ Agreement, Section 9.

Insurance

San Gabriel and ORA have agreed to use the recorded 2004 insurance expense as the basis for projecting ahead to test year 2005/2006, and the difference between their initial estimates was narrowed slightly by their agreement on adding new employees.

San Gabriel broke the account down to components of liability insurance and workers compensation insurance, and inflated each using assumptions developed from its own sources. For its umbrella liability policy, San Gabriel estimated increases of 15% for 2005 and a further 10% for 2006 based on advice from its insurance broker “that insurance premium increases might moderate, but still remain significantly above the general rate of inflation.” These 15% and 10% increases were applied to 2004 liability insurance expenses that were already 24% above 2003. The workers compensation insurance component was up 18% in 2004, and San Gabriel added a further 21% for 2005 over 2004, and 21% again for 2006 over 2005.¹¹

ORA derived its insurance estimate by projecting the 2004 actual data forward using ECSB’s labor inflation factor. San Gabriel asserts that the ORA witness justified this use of the labor inflation factor solely on grounds of consistency with the RCP decision, but then applied a different factor than the CPI-U the decision specifies for escalation years, “because [the ORA witness] claimed ... that he was instructed to do so.” A more complete reading of ORA’s hearing testimony, however, shows that the witness understood that he had full latitude to choose the method and factor best suited to the account and was not

¹¹ Exhibits SG-10, page 10; and SG-8, page 15.

unduly influenced by others. Further, San Gabriel's criticism that the ORA witness used the labor factor rather than the CPI-U to project insurance expense forward to test year 2005/2006 is a distinction without a difference; the two factors are identical for all years 2004 and after.¹² San Gabriel's justification for imputing as it did such very high and compounding year over year increases is weak, and its criticism of ORA's method unfounded. We adopt ORA's insurance estimate.

Regulatory Commission Expense

Most of the charges to this account are the costs of general rate case work, with other regulatory work making up the remainder. The parties were initially far apart in their estimates of regulatory commission expense. Based on its recent Fontana Division general rate case,¹³ San Gabriel expected to incur very high outside counsel expenses in this rate case and sought to amortize them in rates over the 2005/2006 through 2007/2008 rate case cycle. San Gabriel and ORA spent considerable effort in testimony and briefs sparring over whether outside counsel for this rate case was necessary at all. San Gabriel's witness testified, and it argued on brief, that the Commission's longstanding practice is to allow the utility to recover the actual amount expended on outside counsel for its general rate case, or its estimate in the original application, whichever is less. While San Gabriel correctly observes that we did adopt its estimate of regulatory commission expense in the Fontana Division rate case, we did not do so simply because its estimate was lower than San Gabriel's actual costs. Our practice for

¹² ORA-1, Appendix A, ECSB's non-labor and wage escalation rates memo.

¹³ D.04-07-034 (July 14, 2004).

regulatory commission expense is to include an allowance in rates sufficient to cover the utility's reasonable level of expense averaged over the rate case cycle (typically 3 years). Our estimates are forward-looking; the amount we will allow for test year 2005/2006 is not intended to amortize San Gabriel's actual costs of this general rate case, although those costs are an important factor to consider in determining what is a reasonable future level. As we have stated,

It is a well established tenet of the Commission that ratemaking is done on a prospective basis. The Commission's practice is not to authorize increased utility rates to account for previously incurred expenses, unless, before the utility incurs those expenses, the Commission has authorized the utility to book those expenses into a memorandum account or balancing account for possible future recovery in rates. This practice is consistent with the rule against retroactive ratemaking.¹⁴

San Gabriel now acknowledges that this proceeding has not been as contentious and drawn out as it had feared, and in the Comparison Exhibit has reduced its request from \$182,700 to \$80,300. ORA seems to have missed this point and continues to argue in its opening and reply briefs against the former amount and in favor of disallowing all outside counsel costs. San Gabriel's revised estimate is based on its experience to date in this proceeding and represents a reasonable average level of anticipated future expenditures. We will adopt it.

Miscellaneous Expense, and Contamination Litigation Costs

San Gabriel's test year 2005/2006 estimate for miscellaneous expense included \$928,444 in outside legal expenses for LA Division, in two components:

¹⁴ D.04-06-018, the new RCP decision, citing D.92-03-094 (March 31, 1992).

“general,” and “groundwater contamination.” The general component estimate was based on recorded legal expenses for matters other than water quality litigation during 1999 through 2003, escalated by the compensation per hour factor in ECSB’s memo. San Gabriel’s groundwater contamination component was attorneys’ fees and related litigation expense to pursue industrial polluters believed responsible for contaminating LA Division water supplies, and to defend itself against water contamination lawsuits directed against it.¹⁵ ORA recommends allowing miscellaneous expense of \$309,740, thus eliminating essentially all of San Gabriel’s outside legal expenses estimate for the water quality litigation component. ORA would instead require San Gabriel to continue tracking all groundwater contamination-related outside legal expenses, approximately \$618,000 in 2005/2006 by San Gabriel’s estimate,¹⁶ in its existing water quality litigation memorandum account.¹⁷ San Gabriel proposes in this proceeding to amortize the balance of outside legal expenses accrued in the water quality litigation memorandum account. That balance stood at approximately \$3.7 million as of July 2004.

San Gabriel separately tracks the charges and credits in the water quality litigation memorandum account in eight categories, four related to defending

¹⁵ The components of San Gabriel’s estimate are unclear. On the one hand, its witness testified that the outside legal expense estimate related to both pursuing recovery from polluters and defending itself against contamination lawsuits. (Exhibit SG-17, page 12.) On the other hand, San Gabriel indicates on brief that it has not forecasted any legal expenses related to its defense, and that its “groundwater contamination” component is for its pursuit of polluters. (San Gabriel Opening Brief, pages 23 and 20.)

¹⁶ Exhibit SG-17, page 12.

¹⁷ Not to be confused with San Gabriel’s water quality memorandum account, discussed later.

itself (dubbed its “Toxic Tort/Defense”) and four related to its non-defense-related pursuit of alleged polluters (the “Groundwater Contamination” component).¹⁸ San Gabriel has defined the latter four water quality litigation memorandum account categories by EPA-established areas: Baldwin Park Operable Unit (BPOU); Puente Valley Operable Unit; South El Monte Operable Unit; and MTBE (relating to pursuing MTBE polluters in the Central Basin).

In D.02-10-058, our decision in San Gabriel’s previous LA Division general rate case, we denied San Gabriel’s request to recover the portion of its water quality litigation memorandum account associated with defense of water quality litigation, observing that we were considering addressing that topic, among others, for all affected water utilities in a follow-up rulemaking to our then-concluded Order Instituting Rulemaking (R.) 98-03-013 into water contamination issues. We have not yet opened that new rulemaking, and in our more recent D.04-07-034 in San Gabriel’s Fontana Division general rate case, we did authorize San Gabriel to begin recovering those defense-related costs in rates. We will in this order likewise allow San Gabriel to begin recovering its defense-related water quality litigation memorandum account costs (offset by any defense-related amounts received) through December 31, 2004 for LA Division. To protect both San Gabriel and its ratepayers from estimating errors and uncertainties, at the same time the account balance is being amortized in rates, San Gabriel should continue to capture in the water quality litigation memorandum account for later evaluation and possible recovery its subsequent defense-related costs and all defense-related amounts received from polluters and insurers.

¹⁸ Exhibit SG-17, Attachment D, pages 4, 5.

Also in D.02-10-058, we authorized San Gabriel to file an advice letter seeking to amortize the other component of its water quality litigation memorandum account balance, that related to its legal expenses for pursuing polluters. San Gabriel tendered Advice Letter 321 to Water Division for that purpose on January 17, 2003. Water Division thereupon conducted an audit and produced a draft report tentatively concluding that the costs booked in the groundwater contamination categories were substantiated. However, Water Division's investigation also noted for the first time that in one of its lawsuits San Gabriel had reached a settlement with polluters in the BPOU under which San Gabriel would receive \$3.5 million in addition to reimbursements the polluters had agreed to pay for capital and operating costs of remediation facilities.¹⁹ It concluded that San Gabriel should credit those funds to its water quality litigation memorandum account, thus more than offsetting the \$1.4million San Gabriel's Advice Letter 321 was seeking to recover from ratepayers for its litigation costs. The draft report was forwarded informally to San Gabriel for its comments in December 2003.²⁰ On November 17, 2004, Water Division wrote to San Gabriel, stating, "Because of the complexity of the subject matter and related issues, together with your company's non-responsiveness to our staff's audit report, we are rejecting this advice letter to

¹⁹ San Gabriel now estimates that it will receive approximately \$125 million in reimbursements over the next 15 years. It will treat those amounts as contributions and expense offsets, thus keeping the remediation facilities and their operating costs out of rates. At the time of the audit report, San Gabriel had received \$2.1 million of the \$3.5 million award. By the time of this order, it was due to have received \$3.0 million and expected the final \$0.5 million payment to be made in May 2006. (San Gabriel Opening Brief, page 27).

²⁰ Exhibit SG-18.

allow you to address this matter in [the LA Division general rate case].”²¹ San Gabriel and ORA devoted much time and effort in this proceeding attempting to demonstrate whether San Gabriel had or had not properly pursued Advice Letter 321 to completion. Our decision here does not hinge on that answer, but rather on surrounding facts brought out and generally not disputed by the parties in this proceeding.²²

ORA argues that the \$3.5 million award should be credited to the water quality litigation memorandum account to offset litigation costs that would otherwise eventually be picked up by ratepayers.²³ San Gabriel argues that the BPOU settlement did not expressly designate the award amounts as compensation for its litigation costs,²⁴ and that there is no statutory basis for a utility to recover its attorneys’ fees from defendants in this type of litigation. Instead, it considers the \$3.5 million to be damages, and has designated it “Receipts as an Incentive to Negotiate and Not Pursue Court Action” in its

²¹ Exhibit ORA-4.

²² No party took issue with the underlying facts presented in Water Division’s draft audit report, and San Gabriel cited some of them in its prepared rebuttal testimony to support its position (Exhibit SG-17, pages 15, 16).

²³ The parties each referred to Resolution W-4089 and/or W-4094 that authorized San Gabriel and others to establish water quality litigation memorandum accounts. We take official notice of those resolutions. Under Resolution W-4089, mirrored by Resolution W-4094, the utilities were put on notice that each would be “required to justify the reasonableness of all expenses associated with the memorandum account, *offset by insurance proceeds and/or proceeds from the polluters*, before it is granted rate relief” [emphasis added].

²⁴ This cannot be directly confirmed because the BPOU settlement document is not in the record.

supporting workpapers.²⁵ San Gabriel acknowledges that it realized a deferrable gain for tax purposes equal to the amounts received, and is booking the award to capital surplus, thus flowing the entire amount to its shareholders.

According to San Gabriel, all of the award receipts are partial compensation for damages associated with groundwater contamination at its wells, and are thus “a taking or damaging, or involuntary conversion of San Gabriel’s property and rights.”²⁶ San Gabriel cites as precedents conflicting decisions in at least one of which the Commission determined to split evenly between shareholders and ratepayers a contamination award in excess of the utility’s costs.²⁷ We need not explore here disposition of amounts in the memorandum account because we cannot know until litigation has ended whether the total of all amounts eventually recovered (including the \$3.5 million) will exceed, or even match, all of the litigation costs San Gabriel seeks to recover from ratepayers through the account. In the end, San Gabriel acknowledges, “[It is] accurate to conclude that the Commission has no clear directive concerning the ratemaking treatment of damage awards in contamination lawsuits and settlements.”²⁸

As part of the BPOU settlement, San Gabriel granted the polluters a release of liability for its claims, including a release from liability for attorneys’ fees. In effect, part of the consideration it granted the settling counterparties to obtain the

²⁵ Exhibit SG-7, page 17 and Attachment E.

²⁶ Exhibit SG-7, page 18.

²⁷ D.93-09-077, Great Oaks Water Company. Note, however, that the decision was Commission approval of a settlement and thus not to be considered precedential.

²⁸ Exhibit SG-7, page 24.

award was a waiver of any further opportunity it or its ratepayers might otherwise have had to recover litigation costs booked to the water quality litigation memorandum account.²⁹ If we were to approve San Gabriel's request, those litigation costs would now be collected instead from its ratepayers while it books the settlement award as a shareholder gain. That would be unfair. If ratepayers are to be asked to bear litigation expenses, then any recoveries should first be used to offset those expenses. San Gabriel indicates that similar awards have occurred, or may likely occur, as a result of its ongoing litigation against polluters in the three areas other than the BPOU. We will therefore allow San Gabriel to continue to book its pursuit-of-contaminators costs into the water quality litigation memorandum account, and require it to record as offsetting entries the \$3.5 million BPOU settlement award at issue here and any similar awards in the future. That should continue until most or all of San Gabriel's litigation against polluters has been concluded and the final water quality litigation memorandum account balance can be adjudicated. If the amounts recovered eventually exceed San Gabriel's litigation costs, we will make a determination as to how such amounts are to be treated, either for the industry as a whole, perhaps in the follow-up water contamination rulemaking proceeding referred to earlier, or in a proceeding involving only San Gabriel.

²⁹ We need not assume that San Gabriel would have been entitled to, or would have recovered, its attorneys' fees to give weight to this possibility. It is enough to observe that at least some of the settling parties themselves considered it a sufficient possibility to merit including a release in the BPOU settlement agreement.

Utilities and Rents

San Gabriel and ORA show \$14,000 and \$13,700, respectively, as their estimates of utilities and rents. The Agreement, their testimony, and San Gabriel's opening brief indicate they have reached almost complete agreement on this account, with the small remaining difference being due to uncertainty of which inflation factor to use to project past costs to test year 2005/2006. Lacking any further information as to which factor each used or why, we will allow \$13,850.

General Office Allocations

Differences in the parties' general office expense estimates typically parallel those discussed above for LA Division. For those general office expense categories (*e.g.*, payroll, pensions and benefits, insurance), we adopt the same issue by issue outcomes that we determined for LA Division above, rather than repeat our discussions here. The only two issue areas that are unique to general office are discussed below: outside auditing services, and postage.

General Office – Outside Auditing

To estimate this account, ORA used an average of five years' recorded data adjusted for inflation, and escalated it to the test year using ECSB's factors. San Gabriel began with 2003 recorded, added \$30,000 in 2004 for "increased complexity and number of federal tax laws passed in recent years," and escalated both the 2003 recorded and \$30,000 figure by 12% annually thereafter due to the more rigorous accounting standards imposed on public accounting firms under the federal Sarbanes-Oxley Act of 2002.³⁰ San Gabriel's exhibit shows that its

³⁰ Exhibit SG-13, page 2.

total tax-related fees in 2003 allocated to LA Division were \$10,500, and its estimate would raise that to about \$49,500 in test year 2005/2006.³¹ We agree that Sarbanes-Oxley has had an impact on public companies, and we therefore accept San Gabriel's higher escalation rate to reach test year 2005/2006. But we also remove San Gabriel's \$30,000 adjustment in 2003 for "Other Tax Consulting Fees" (escalated to about \$35,600 in the 2005/2006 test year) as being inadequately supported and unreasonable.

General Office – Postage

Both San Gabriel and ORA estimated test year 2005/2006 postage expense based on 2003 recorded data adjusted for expected customer growth. San Gabriel, however, also applied ECSB's composite non-labor escalation factor to bring the 2003 recorded figures forward to 2005/2006. ORA argues that there is no evidence that the U.S. Postal Service will increase postage rates during the test year.³² The difference is significant, about \$38,000, or 9%. San Gabriel sees the question as not whether postage rates will increase, but when. While we agree that postage rates will eventually increase, it is San Gabriel's postage rates in 2005/2006 that concern us here.³³ ORA's estimate is based on today's postage rates, and there is no evidence indicating they are likely to increase in 2005/2006.

³¹ Exhibit SG-13, Attachment A.

³² ORA's position is consistent with the outcome on postage we adopted in San Gabriel's last general rate case; San Gabriel's is not. In D.02-10-058, San Gabriel and ORA recommended, and we accepted, basing postage expense on the U.S. Postal Service's proposed rate increase to take effect in the summer of 2002. (D.02-10-058, Attachment A, Item 23).

³³ Postage expense increases for the second and third years will be determined later by applying escalation factors as set forth in the RCP.

We adopt ORA's estimate as being closer to what San Gabriel will likely experience in the test year.

Depreciation Expense and Ad Valorem Taxes

The differences between San Gabriel's and ORA's estimates of depreciation expense and ad valorem taxes, for both LA Division and general office, are due to differences in their estimates of test year plant in service.

Rate Base

San Gabriel and ORA were initially far apart in their estimates comprising rate base for test years 2005/2006 and 2006/2007.³⁴ They were eventually able to resolve most of their differences and considerably narrow the gap, but there are still significant issues separating them. Both have agreed to adopt San Gabriel's December 2004 recorded rate base as the starting point for calculating plant additions in the test years, and San Gabriel accepts ORA's estimate of routine plant additions at \$1,997,600 per year thereafter. Most importantly, after coming to agreement on the cost and timing of some of San Gabriel's proposed plant additions, they concurred that many other specific capital projects for which the timing and capital costs are uncertain are nonetheless needed and should be reflected in rates through an advice letter process as they are completed and placed in service. An advice letter process would address in part ORA's observation that over the past rate case cycle San Gabriel has greatly overestimated its company-funded plant additions and then underspent the

³⁴ The new RCP provides for one test year and two escalation years for establishing revenue and expense components in general rate cases, and two test years plus one escalation year for rate base components.

Commission-authorized amounts.³⁵ Their joint recommendation is described in the Agreement, Sections 4 and 9, and listed on a project by project basis in Appendix C to the Comparison Exhibit.

We see advantages to the parties' advice letter recommendation, but we have reservations as well. San Gabriel would benefit by the increased certainty of timely rates to support the reasonable costs of needed additions as they enter service over the coming three years. Ratepayers would benefit by reducing San Gabriel's incentive to increase shareholder profits by delaying or canceling projects the Commission has authorized and included in advance in rates. At the same time, however, we note that a major goal of the new RCP is to manage regulatory workload for both the water companies and Commission staff. Comparison Exhibit Appendix C lists 16 separate projects for which the parties would have us authorize advice letters. When the two escalation year adjustment advice letters and the two new payroll expense offset advice letters are included, San Gabriel, ORA, Water Division and the Commission could be tasked with evaluating and adjudicating as many as 20 individual San Gabriel rate increases over the coming three-year rate case cycle. This would be exceedingly burdensome for all participants and confusing to customers. Thus,

³⁵ According to ORA, San Gabriel sought \$16.4 million for company funded projects in test year 2002, the Commission adopted \$8.3 million, and San Gabriel spent \$3.8 million. The corresponding figures for attrition year 2003 were \$13.7 million requested, \$9.0 million adopted, and \$6.8 million spent. San Gabriel confirms the amounts actually expended but takes issue with the conclusion ORA draws from the data. (Exhibit ORA-1, ¶5.11, and Exhibit SG-15, page 8). San Gabriel's application shows the Commission adopted an \$81.3 million rate base for test year 2003, but the recorded figure later came in much lower, at \$77.6 million. This was a factor in San Gabriel's recording a 10.02% return on rate base in 2003, compared to the Commission's adopted 9.40%. (A.04-09-005, page 6).

we will adopt the parties' rate base joint recommendation with one qualification. San Gabriel will be allowed to file no more than two advice letters during each fiscal year seeking rate increases for the capital costs of the plant additions listed and the Water Quality Specialist and Water Treatment Operator III offsets.³⁶ San Gabriel may group multiple completed and in-service plant projects and/or personnel positions into each advice letter, and may time its filings as it sees fit. To reduce the burden of evaluating any cost overruns outside of the general rate case process, and to protect ratepayers from potentially unlimited increases, the estimated costs in Comparison Exhibit Appendix C will serve as caps on the cost of each plant project for advice letter increase purposes. Cost overruns on these projects, if any, may not be reflected in rates until they are presented for examination in the first test year of San Gabriel's next general rate case cycle (currently anticipated to be 2008/2009).

San Gabriel and ORA identify three primary rate base issues for the Commission to adjudicate: (1) the method for calculating average test year plant and other components of rate base; (2) San Gabriel's proposed general office expansion project; and (3) San Gabriel's proposed general division allowance for annual investment in new meters. We discuss each below.

Average Test Year

San Gabriel and ORA differ with respect to their methods for calculating average utility plant for the test years, and average test year amounts for other

³⁶ See our discussion authorizing offset advice letter filings for Water Quality Specialist and Water Treatment Operator III positions in the Payroll section of this order.

rate base items such as materials and supplies and working cash.³⁷ San Gabriel would use the average of its beginning and end of test year estimates. ORA would use the December 31st estimated figures as the averages for the 2005/2006 and 2006/2007 test years. San Gabriel argues that, unless forecasted capital expenditures during successive calendar years are equal in amount, ORA's approach will produce an inaccurate result. That is true. The same is true, however, of San Gabriel's method: Unless expenditures in successive halves of a fiscal test year are equal, San Gabriel's method will also produce an inaccurate result. All Class A water companies are required under General Order 104 series to file annual reports with the Commission, and those reports are on a calendar year basis. And, to the best of our knowledge, all Class A water companies maintain and close their books on a calendar year basis, and most if not all budget on a calendar year basis. Thus, recorded end-of-calendar-year data is more readily available, and likely more accurate, than data for fiscal years. Both parties' methods require assumptions that spending is uniform through consecutive future periods, and we see no advantage in either in that regard. For fiscal test year Class A water companies, however, ORA's end-of-calendar-year method has the advantage of being simpler, and the results more readily compared with available recorded data. Since ease of use is a major goal of our new RCP, we adopt ORA's method for this proceeding.

³⁷ The parties' difference over this issue makes their current rate base positions in the Comparison Exhibit (Comparison Exhibit Appendix A, page 2) appear much further apart than they actually are. San Gabriel offers a lengthy explanation in its Opening Brief of why this is so.

New General Office Facility

San Gabriel has proposed to include in its 2005, 2006 and 2007 construction budgets \$10.675 million to expand or replace its general office headquarters building in El Monte. San Gabriel's general office and LA Division capital budgets include \$900,000 and \$1,100,000 respectively to acquire an office site, and an additional \$2.4 million, \$3.0 million, and \$3.275 million in 2005, 2006 and 2007 to construct and equip the new facility. The \$10,675,000 total is shown at issue in the Comparison Exhibit, Appendix C, under "New Office Building."

According to San Gabriel, the existing facility lacks sufficient work, storage, and parking space, and its air conditioning, telephone and electric systems are inadequate. The main portion of the existing office building was constructed in 1965, and adjoining properties were last acquired for expansion in 1980 and 1986. The consulting firm engaged to look at various alternatives produced a budget cost analysis with four scenarios ranging in cost from \$5.3 million to \$9.2 million.³⁸

ORA opposes including the new facility in San Gabriel's adopted budget for this general rate case cycle. ORA toured the existing facility and determined that it has adequate work, storage, and parking space for San Gabriel's workforce. San Gabriel is currently converting an unneeded meter repair shop into additional office space, and San Gabriel and ORA have agreed on a lower number of new employees for this rate case cycle than San Gabriel initially requested. Most importantly, ORA argues that San Gabriel has not conducted a

³⁸ These figures include the building and site improvements plus a 10% contingency, but not the costs of land, furnishings, and other necessary improvements to complete the facility. (Exhibit SG-9, Attachment A).

space planning study before proposing to the Commission what appears to be the most expensive alternative, acquiring an additional parcel near the existing site or elsewhere to construct a new office building.³⁹ ORA would have San Gabriel first evaluate other available and less expensive alternatives to meet its needs, perhaps including leasing rather than building, or converting to office space one of its two employee cafeterias on the present site.

We have some of the same reservations as ORA expresses, and questions that neither party's evidentiary presentation seems able to answer. Before committing more than \$10 million to constructing entirely new facilities, it would be prudent to examine a complete range of potential alternatives. As we discussed earlier, any rate base additions we approve during this rate case cycle would automatically be reflected in rates regardless of whether San Gabriel decided to proceed on our adopted schedule or not, so San Gabriel owes its ratepayers no less than a thorough study of their need.⁴⁰

We are also concerned because the parties' presentations leave very unclear just what the project budget covers and how it is divided between the general office and San Gabriel's two operating divisions. Neither party has presented a complete, consistent estimate of what has already been spent, what

³⁹ When asked whether San Gabriel's consultant had performed a space study, San Gabriel's witness responded, "No, we did not have them do that. We... will do a space study actually every day when we walk in the building. We are cramped, we have no additional space for offices, we double up parking from day-to-day. We need space." (RT 53.)

⁴⁰ "We remind the parties that GRC proposals for major capital projects presented in the application must include need analysis, cost comparison and evaluation, conceptual designs, and overall budget." (D.04-06-018 at 14, describing the new RCP requirements.)

will be spent for what purposes each year going forward, and which parts will be charged to which operating division and San Gabriel's unregulated operations. For example, San Gabriel shows \$900,000 for "Office Site Acquisition" in its calendar year 2004 common plant capital budget, another \$900,000 for structures and improvements in 2005, and additional amounts in 2006 and 2007.⁴¹ Other figures apparently related to the new facilities are scattered through the LA Division capital budgets between calendar years 2005 and 2007. The most recent figure is that in the Comparison Exhibit, but that consists solely of one \$10.675 million lump sum for the 2005 thru 2007 period and seems to contradict the 2004 figure presented in San Gabriel's rebuttal testimony presented in January 2005.⁴² Nowhere does San Gabriel state that project expenditures have actually begun as implied in the 2004 capital budget presented at the evidentiary hearings. Indeed, on brief it refers to "the preliminary state of its construction plans for this project...." San Gabriel's project at this point remains largely undefined and appears to be little more than a general rate case placeholder.

The immediacy of San Gabriel's expansion need is also called into question by the fact that the LA Division has reached near ultimate build-out, has experienced very little growth in recent years, and very little growth is projected through this rate case cycle.⁴³

On balance, we agree with ORA's conclusion and will not include the project in rates in this general rate case cycle. Adopting San Gabriel's proposal

⁴¹ Exhibit SG-15, Attachment 4, and Exhibit SG-1, page 6-2.

⁴² Exhibit SG-15, Attachment 4.

⁴³ Exhibit SG-2, page 2-1. The record does not reflect the growth status of San Gabriel's Fontana Division, but neither does San Gabriel cite that as a primary factor.

entails too large a risk that San Gabriel may later scale down, postpone, or cancel, leaving ratepayers once again paying shareholders for facilities that were never constructed. San Gabriel needs to do a more detailed study to firm up its needs and evaluate a complete range of options. It could then come back to the Commission with a well defined project in the next general rate case cycle.

Common Utility Plant – Meters

San Gabriel and ORA differ in their estimates of meter additions in common utility plant. ORA forecasted \$315,700 annually for this capital item based on a five-year average. San Gabriel estimated \$350,000 without explaining how it arrived at that number. We adopt ORA's figure.

Other Rate Base Components

There are no substantive differences remaining between San Gabriel's position and ORA's position regarding other rate base components.⁴⁴ Differences appearing in Appendix A, page 2 of the Comparison Exhibit are due to estimating differences in other areas already discussed.

Cost of Capital

In order to determine a fair rate of return for a utility, we determine the proportions of long-term debt and equity in its capital structure, estimate what the effective cost of each should be, and then take a weighted average. The result is the rate of return on rate base used to determine the revenue requirement in the summary of earnings.

San Gabriel and ORA were initially far apart. San Gabriel sought a constant 11.17% return on rate base for each year of the three-year rate case cycle,

⁴⁴ Materials and supplies, working cash, depreciation reserve, contributions, deferred taxes, and common utility allocations.

based on a 12.00 return on equity each year.⁴⁵ ORA responded with a study recommending returns on rate base of 8.95% to 8.99%, based on a 9.4% return on equity, a cost of debt the same as San Gabriel estimated, and an imputed 55% equity ratio to offset the high ratepayer costs of San Gabriel's 76% average equity ratio.

Cost of capital is frequently one of the most contested components in water general rate cases. It has a direct and easily observed effect on customers' rates and shareholders' profits, but its determination is by necessity more subjective and less susceptible to direct measurement, escalation and trending than are many other ratemaking estimates. By the time of the evidentiary hearing the parties had reached agreement on all of the components necessary to establish San Gabriel's rate of return for test year 2005/2006, as shown in the following table:

Table 2
Cost of Capital and Rate of Return

	Test Year 2005/2006 Escalation Years 2006/2007 and 2007/2008		
	Capital Structure	Cost	Weighted Cost
Long-Term Debt	40%	8.42%	3.37%
Common Equity	60%	10.10%	6.06%
Total	100%		* 9.43%

* Rate of return on rate base

At the evidentiary hearing, the parties' represented that it was unnecessary to call their respective cost of capital witnesses, and from all appearances there

⁴⁵ San Gabriel's constant 11.17% return on rate base resulted from estimating an increasing cost of debt precisely offset by a decreasing proportion of equity in the capital structure.

was complete agreement to all issues involving cost of capital and rate of return for the proceeding. On brief, however, San Gabriel sought to insert an element of financial attrition into the two escalation years, one that was not mentioned in the Agreement. By pulling figures from the Agreement and the prepared testimony, San Gabriel was able to construct in its opening brief hypothetical costs of capital and rates of return for projected years 2005 through 2008, averaged them to produce estimates for 2006/2007 and 2007/2008, and argued that they should be adopted as the basis for a financial attrition adjustment in each of the two escalation years.⁴⁶ ORA disagreed, citing the newly adopted RCP. The difference is small: San Gabriel now seeks to increase its 9.43% rate of return for 2005/2006 to 9.45% and 9.46% for the two escalation years, compared to 9.43% for all three years for ORA.

ORA is correct. Under the previous RCP, we did indeed apply both operational and financial attrition adjustments to determine a water utility's single attrition year rate adjustment. Faced with the requirements of Pub. Util. Code § 455.2, however, we adopted a new RCP with "a simplified, inflation-based escalation methodology for two years of the three-year cycle."⁴⁷ Our goal was to streamline the rate case process; the press of handling general rate cases for every district of every class A water utility every three years would permit nothing else. The old attrition-based RCP, and the operational and financial attrition methodology it embraced, is now superseded. As ORA points out, part

⁴⁶ In testimony filed with its application, San Gabriel stated, "There is no forecasted financial attrition as the proposed cost of money is 11.17% in all years." (Exhibit SG-2, page 11-2.)

⁴⁷ D.04-06-018, page 1.

of our simplification was adopting a uniform cost of capital and rate of return for all three years, as implied in the Cost of Capital section of the new RCP. Even under our procedures as simplified so far, however, developing the cost of capital and rate of return for a single test year remains a complicated undertaking, and the parties in this proceeding spent considerable time and effort in developing voluminous prepared direct testimony on the issue. As we indicated in D.04-06-018, in Phase II of the RCP proceeding we intend to take the next step and develop a simple approach to cost of capital itself. For today's decision, we adopt the 9.43% rate of return for 2005/2006 that the parties have agreed on, and it becomes as well the basis for step rates in the two escalation years.

Income Taxes

The parties concur on all aspects of income taxes except two affecting only the federal return: the deduction for interest expense, and effects of the American Jobs Creation Act of 2004. All other differences between their income tax estimates are due to differing estimates in other areas.

Interest Expense Deduction

The Commission's longstanding and widely accepted practice has been to recognize that interest on debt is deductible for federal income tax purposes. Here, ORA determines that interest deduction by multiplying the adopted, weighted cost of debt by adopted rate base. San Gabriel does the same, but first subtracts working cash and deferred income taxes from rate base.

For support, ORA cites D.03-12-040 wherein the Commission stated, "Both parties use the same methodology to calculate [the] interest deduction – weighted cost of long-term debt multiplied by the rate base." San Gabriel says it "is unable to discern any relevant statement of policy in that decision." Whether that is a

statement of policy or not is a matter of semantics. What D.03-12-040 does have is a statement of the method the Commission has used. San Gabriel's witness defended its method by saying it was used in San Gabriel's most recent rate case, D.04-07-034.⁴⁸ An examination of D.04-07-034, however, reveals no discussion of this topic and thus does even less to support San Gabriel's position than San Gabriel says D.03-12-040 does for ORA's. Neither party provides any further explanation of why its method is the better.

The Commission has long approximated the amount of a water utility's interest deduction for income tax purposes by multiplying the adopted, weighted cost of long term debt in the capital structure times the total amount of debt and equity capital shareholders have dedicated to utility service and upon which they are being paid a return by ratepayers. Thus, the interest deduction is the adopted weighted cost of debt times adopted rate base. To do otherwise here would be to require ratepayers to compensate San Gabriel's shareholders for their cost of interest on borrowed capital while denying ratepayers the benefit from reduced taxes part of that interest will generate. We adopt the interest deduction as the adopted, weighted cost of debt multiplied by adopted rate base.

American Jobs Creation Act

ORA included in its federal income tax calculations a 3% deduction for the effects of the American Jobs Creation Act of 2004.⁴⁹ San Gabriel did not. A

⁴⁸ Exhibit SG-14, page 26.

⁴⁹ Public Law 108-357 (108th Cong.), enacted October 22, 2004.

Commerce Clearinghouse bulletin San Gabriel introduced into evidence provides background:⁵⁰

[T]he new deduction will effectively reduce the corporate income tax rate for domestic manufacturing three percentage points, from a top rate of 35 percent down to 32 percent. More good news is that lawmakers have defined ‘manufacturers’ (and their underlying ‘production activities’) very broadly.

* * *

The new deduction... starts at a transition percentage of three percent for 2005 and 2006; and will rise to six percent for 2007 through 2009 [and nine percent when fully phased in by 2010].

* * *

Many businesses may be surprised that they qualify as ‘manufacturers.’

* * *

Treasury and the IRS are going to have to draft regulations explaining what business activities qualify as ‘manufacturing’ for the new deduction.

Two sentences San Gabriel’s witness quoted, assertedly from the House Conference Report (not in evidence), suggest that San Gabriel is likely to receive partial, but perhaps not complete, benefit from the Act: “[G]ross receipts attributable to the storage of potable water or the delivery of potable water to customers do not give rise to qualified domestic production gross receipts. A taxpayer that both produces and distributes potable water must properly allocate gross receipts between qualifying and non-qualifying domestic gross receipts.”

⁵⁰ Exhibit SG-13, Attachment E.

Thus, San Gabriel's position is that it is uncertain at this time whether the Act applies to San Gabriel or, if it does, to what extent. San Gabriel recommends the Commission assume for purposes of this proceeding that it will receive no benefit, and instead open a generic proceeding to address the effects, if any, of the change on the various classes of public utilities.

Shareholders should not receive compensation from ratepayers for taxes the utility will not have to pay. The amount at issue is potentially large, \$235,000 in test year 2005/2006 according to one estimate, and may triple as the full deduction (up to 9%) is phased in through tax year 2010. We conclude there is a strong likelihood San Gabriel will receive some as-yet-unquantifiable tax benefit from the Act. However, for purposes of this rate case cycle, we will not impute a specific tax benefit amount. Instead, the amount of San Gabriel's adopted revenue requirement that results from our computational assumption that the Act does not apply will be collected in rates and held subject to refund pending our order finally establishing in a future proceeding the actual tax benefit, if any, conveyed to San Gabriel under the Act. That future proceeding may be either a future San Gabriel general rate case or another, more generic proceeding involving other utilities as well. San Gabriel is to report the amount collected and the status of its tax liability under the Act in each general rate case until we have made a final determination.

Rate Design

Rate design is not mentioned in the Agreement, but ORA has not taken issue with San Gabriel's proposal to follow the Commission's current standard rate design policy. We will do so.

On May 5, 2005, after this proceeding was submitted, the Commission issued D.05-05-015 authorizing San Gabriel to file an advice letter implementing a

new low-income rate relief program, “CARW” (California Alternative Rates for Water), in its Fontana and LA Divisions. It further ordered the Commission’s Water Division to “coordinate San Gabriel’s CARW filing with its new rates for 2005,” *i.e.*, those resulting from today’s general rate case order. Thus, the rates we order today following the standard rate design policy will also be supplemented by San Gabriel’s CARW advice letter filed separately pursuant to D.05-05-015.

Escalation Years

The new RCP provides for one test year and two escalation years for establishing revenue and expense components in general rate cases, and two test years plus an extrapolated third year for rate base components. We first estimate the test year 2005/2006 expenses (including in this case, those for the general office), rate base, and needed rate of return. Our summary of operations calculation using those figures generates an adopted revenue requirement for the test year. Using adopted customer and consumption levels, we design 2005/2006 rates to match the adopted revenue requirement figure. It is these figures and rates we actually adopt in the GRC; the increase figure for the test year is simply the difference between the adopted revenue requirement and revenue at present rates.

The revenue requirement for the second year begins with the adopted 2005/2006 test year figures for customers and consumption, expenses, and rate of return, and our general rate case adopted rate base for 2006/2007. The number of customers is increased using a simple, five-year average percentage change.⁵¹ Expenses are increased by a combination of customer growth and the then-most recent “Estimates of Non-labor and Wage Escalation Rates” and “Summary of Compensation per Hour” as published by ECSB (or, for items not covered by the ECSB rates, the most recently available, recorded, 12-month-ending change in the U.S. Cities CPI-U as published by ECSB).⁵² A summary of operations calculation using those figures (with possible adjustments for significant, nonrecurring

⁵¹ D.04-06-018, page 11.

⁵² D.04-06-018, page 12.

items, as defined in D.04-06-018) once again generates a revenue requirement, this time for the second year, escalation year 2006/2007. The difference between the second and first year revenue requirements, adjusted if necessary by the results of the earnings test,⁵³ determines the first escalation year rate changes to be made effective July 1, 2006.

Calculations for the third year parallel those for the second, except rate base is determined by extrapolating from the first two years to the third.⁵⁴ The proposed escalation year rates are to be consistent with the Commission's standard rate design policy and D.05-05-015 (addressing low income rates).

We establish in this decision the 2005/2006 summary of earnings figures, rate base for 2006/2007, and the authorized rate of return for this three-year rate case cycle. The revenue requirements and revised rates for the second and third years, escalation years 2006/2007 and 2007/2008, will not be fully determined until advice letters for those years based on ECSB's then-current escalation factors and the results of the earnings test are filed and evaluated in mid-2006 and mid-2007.

⁵³ D.04-06-018, Appendix page 16.

⁵⁴ The Commission formerly used a concept of "operational attrition" to achieve the same result. Operational attrition was the expected change (positive or negative) in earned rate of return if test year one rates were continued into test year two. Operational attrition incorporated expected changes in all elements of the summary of earnings – customers, consumption, expenses, and rate base. Operational attrition was added to "financial attrition" (the change in adopted rate of return from year two to year three) and the sum multiplied by test year two's rate base determined the step rate increase needed in year three. The operational attrition figure thus represented a composite extrapolation of all summary of earnings elements, including rate base, from years one and two into year three. The separate concepts of operational and financial attrition are no longer relevant under the new RCP.

Water Quality Memorandum Account

San Gabriel's application asks for:

Authori[ty for] San Gabriel to add to its Water Quality Memorandum Account future expenditures related to water quality, including, but not limited to, the capital costs and operations and maintenance expenses of needed wellhead treatment facilities that cannot reasonably be forecasted and also to record any reimbursements from polluters or government funding proceeds received for the construction and operation of the new treatment facilities....⁵⁵

According to its prepared testimony submitted with the application, "This proposal is identical to that made in the last general rate case (Application (A.) 01-10-028) for the LA Division in compliance with Ordering Paragraph No. 3 of D.94-06-033 in Order Instituting Investigation 90-11-033...."

D.94-06-033, Ordering Paragraph 3, provides:

3. A water company subject to the jurisdiction of this Commission, by application or as part of a general rate case, may seek authorization to add to its Water Quality Memorandum Account (established pursuant to Resolution No. W-3784) those prospective water quality costs that are beyond the control of the company and (a) were not foreseeable and therefore were not included in the company's last general rate case, and will be incurred prior to the company's next general rate case, or (b) cannot be estimated accurately for inclusion in a current rate case.

⁵⁵ A.04-09-005, page 12.

Resolution W-3784 to which D.94-06-033 referred established and defined water quality memorandum accounts⁵⁶ as follows:

Each water utility regulated by the Commission and subject to the provisions of the National Primary Drinking Water Regulations and Department of Health Services' Office of Drinking Water fees and expenses is authorized to establish a memorandum account in which to record payment of water sampling and testing costs which are not already covered in rates and payments to Department of Health Services.⁵⁷

According to San Gabriel, the Commission already granted the authority it seeks in San Gabriel's last general rate case decision, D.02-10-058, and San Gabriel is merely seeking to renew or extend it unchanged.

After examining D.02-10-058 and the adopted, joint recommendations appended to it, we conclude there is no reference to D.94-06-033, to Resolution W-3784, or to the water quality memorandum accounts Resolution W-3784 established. There is one reference to San Gabriel's "water quality memorandum account," but that occurs in the discussion of a separate issue involving repeated references to San Gabriel's water quality *litigation* memorandum account, bears no apparent relation to the authority San Gabriel is requesting here, and appears from the context to be a typographic error there, and in any case is irrelevant here. The only other reference in that decision we can discern that may be relevant is Item 5 from the adopted ORA & San Gabriel Joint Recommendations appended to the decision. Item 5, however, grants San Gabriel "balancing

⁵⁶ Not to be confused with San Gabriel's separate water quality *litigation* memorandum account, discussed earlier.

⁵⁷ Resolution W-3784, Ordering Paragraph 1.

account protection for any variances in the amounts San Gabriel ultimately incurs for the construction and operation of the new treatment plant facilities and compensation San Gabriel receives for the construction and operation of the new treatment facilities.” The “treatment plant facilities” referred to in Item 5 are specifically identified as Plant B5 and B6 treatment plant additions, not the broad authority San Gabriel seeks to track *all* future expenditures related to water quality that cannot be forecasted.

ORA opposes San Gabriel’s request. San Gabriel indicates on brief that ORA has inaccurately summarized its proposal, and implies that ORA does not understand San Gabriel’s position. Likewise, San Gabriel indicates on brief and in testimony that it is uncertain of ORA’s position. The muddled testimony in this proceeding makes it abundantly clear that both are true -- neither party understands the other’s position, nor do we.⁵⁸

None of the citations the parties provide appears likely to have been the source for the authority San Gabriel believes it already has and/or would like granted, renewed, or extended. Authority to continue a memorandum or balancing account, once granted, need not be renewed in subsequent decisions unless the Commission has imposed future expiration as a condition on the account. San Gabriel has not justified granting a new account, or expanding an existing account, of a type contemplated by any of the citations it references. San Gabriel’s request is denied.

⁵⁸ To add to the confusion, San Gabriel throughout its testimony and brief continually switches its references to the desired account back and forth between “balancing account” and “memorandum account.” It never succeeds in clarifying just *which type* of account it believes was authorized or would have us authorize. The distinction is significant. *See* D.00-03-053, footnote 3.

Full Cost Balancing Accounts

San Gabriel currently has purchased water, pumped water, and purchased power balancing accounts that insulate it against expense changes due to fluctuations in the rates it pays to its suppliers for those commodities. Expense changes due to volume changes are usually offset by corresponding increases or decreases in sales revenues. In this application San Gabriel requests authorization to expand those balancing accounts to cover its full costs for purchased water, pumped water, and purchased power. As it states in the application, full cost balancing accounts would “greatly simplify computations, but [...] differ from those required by D.03-06-072.”⁵⁹ San Gabriel provides two primary reasons in support: that the complexity of its Southern California Edison power charges and the various charges it pays for purchased water and pumped water make it difficult to follow the standard balancing account procedures; and full cost balancing accounts “will exactly offset the expenses at any level of sales,” thus protecting ratepayers by ensuring they bear only the actual costs the utility incurs.

ORA is opposed. While it acknowledges that the Commission authorized San Gabriel to continue full cost balancing accounts for its Fontana Division in its recent general rate case,⁶⁰ ORA believes the record fails to show that the same justifications exist here. According to ORA, San Gabriel’s proposal would be an

⁵⁹ D.03-06-072, *Final Decision Revising the Procedures for Recovery of Balancing-type Memorandum Accounts Existing On or After November 29, 2001*, issued in R.01-12-009, *Order Instituting Rulemaking on the Commission’s Own Motion to Evaluate Existing Practices and Policies for Processing Offset Rate Increases and Balancing Accounts in the Water Industry to Decide Whether New Processes are Needed*.

⁶⁰ D.04-07-034 (July 8, 2004).

unprecedented use of a balancing account afforded no other Commission-regulated water utility. ORA argues that when water sales increase, San Gabriel would calculate a balance due from ratepayers while at the same time collecting and retaining the revenues from those increased sales. San Gabriel counters by arguing that its revenues after amortization of a full cost balancing account would exactly offset its expenses at any level of sales. But ORA is correct. Since the quantity rates are set to recover all of the utility's variable costs and part (approximately one-half) of its fixed costs, when sales are more than estimated, San Gabriel would collect more than its increased variable costs in rates, yet would still calculate an additional balance due from ratepayers through a full cost balancing account. The offsetting revenues entered into the full cost balancing account to which San Gabriel refers are only a fraction of its higher revenues due to increased sales; the remainder would not enter the balancing account but would instead benefit San Gabriel's bottom line. The reverse would be true when sales are less than forecast, but we describe next other factors that could come into play to upset the symmetry.

San Gabriel's proposal would further increase its profits when sales increase to above the rate case forecast, and further depress profits when sales decrease. This would create a disincentive for San Gabriel to promote water conservation among its customers. Full-cost coverage for pumping power and water supplies greatly reduces the incentive to react quickly to main breaks and customer-reported leaks, and to invest in projects to reduce system water losses. Full-cost coverage for pumping power creates a disincentive to monitoring and investing in maintenance, repairs and replacements as pump efficiency degrades over time. In summary, the potential benefits to ratepayers of full cost supply

balancing accounts are greatly outweighed by the perverse incentives that such balancing accounts would create.

Lastly, San Gabriel's rate of return witness made the effect of the Commission's standard balancing account rules a major pillar of support for his conclusion that San Gabriel faces higher than normal risk and thus merits a higher return on equity. The parties give no indication how their agreed rate of return should be adjusted should the Commission change San Gabriel's risk profile and increase its potential for profit by granting it full cost balancing accounts that others do not enjoy.

We conclude that full cost balancing accounts for San Gabriel's LA Division are not in the public interest and should not be authorized.

Amortizing Balancing Accounts

San Gabriel asks for authorization to begin amortizing the amounts recorded in its purchased water, pumped water, and purchased power balancing accounts. According to San Gabriel's testimony, it has submitted several advice letters for various periods since its last successful filing that amortized the November 2001 balances, but at the time this application was being heard they had not been approved for various reasons. San Gabriel's request is unopposed, and we are not aware of any reason it should not be granted. We will authorize San Gabriel to amortize the balances in its purchased water, pumped water, and purchased power balancing accounts for LA Division as of December 31, 2004, or such later date as San Gabriel and Water Division may jointly agree, subject to the Commission's and Water Division's standard procedures for validating the amounts claimed in the advice letter.

Water Quality and Service Quality

Under the new RCP, in each general rate case the Commission examines the utility's district-by-district compliance with water quality standards. San Gabriel addressed the topic; ORA did not.

San Gabriel's witness testified that since 2000 it has been in compliance with all water quality regulations; has not deviated from accepted water quality procedures; has not been cited, fined, or otherwise disciplined by any governmental agency that regulates water quality; and its water has not exceeded any maximum contaminant level. San Gabriel included in its testimony copies of its 2001, 2002 and 2003 Annual Water Quality Reports to customers for LA Division as confirmation. There was no cross-examination on these topics, and ORA did not contest San Gabriel's showing. We see no reason to question San Gabriel's assertion that it has complied fully with applicable water quality standards in its LA Division during the recent three-year period.

San Gabriel presented an analysis of service complaints and inquiries in LA Division between 1998 and 2003. That analysis shows a low number of complaints regarding water quality, with no significant trend either upward or downward. The great majority of complaints and inquiries concerned either leaks or billing, and those show a favorable downward trend over the period. Only two customers spoke at the public participation hearing. Both complained of high rates, and one faulted San Gabriel for bad tasting water. San Gabriel's analysis shows that it has averaged about ten complaints about water taste or odor per year over the past six years. Considering that San Gabriel has approximately 47,000 customers in LA Division, and the fact that ORA chose not to raise any service issues, we conclude that San Gabriel provides adequate service in LA Division.

Comments on Proposed Decision

The principal hearing officer's proposed decision was filed with the Commission and served on all parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed by _____.

Assignment of Proceeding

Michael Peevey is the Assigned Commissioner and James McVicar is the assigned ALJ in this proceeding.

Findings of Fact

1. The agreed outcomes San Gabriel and ORA jointly recommend in their All Parties Joint Stipulations and Comparison Exhibit, and the outcomes to disputed issues set forth in the body of this decision, are reasonable for our purposes in this proceeding except as otherwise set forth in this decision.
2. The capital structure, cost of debt, rate of return on equity, and rate of return on rate base shown in Table 2 are reasonable for San Gabriel's LA Division for the 2005/2006 through 2007/2008 general rate case cycle.
3. The adopted summary of earnings presented in Attachment A, and the adopted quantities and calculations included as Attachment C that underlie it, are reasonable for ratemaking purposes.
4. San Gabriel has reached a settlement with polluters in the BPOU under which San Gabriel is receiving \$3.5 million in excess of reimbursements the polluters agreed to pay for capital and operating costs of remediation facilities in LA Division.
5. As part of the BPOU settlement, San Gabriel granted the polluters a release of liability for its claims, including a release from liability for attorneys' fees.

6. Part of the consideration San Gabriel granted the settling counterparties to obtain the \$3.5 million settlement was a waiver of any further opportunity it or its ratepayers might otherwise have had to recover from those parties its litigation costs booked to the LA Division water quality litigation memorandum account.

7. Other settlements similar to the BPOU settlement have occurred, or may likely occur, as a result of San Gabriel's ongoing litigation against polluters in the three areas of LA Division other than the BPOU.

8. It cannot be known until litigation has ended whether the total of all amounts eventually received from polluters, including the \$3.5 million at issue here, will be less than, the same as, or more than the total litigation costs San Gabriel will seek to recover from ratepayers through the LA Division water quality litigation memorandum account.

9. San Gabriel should be authorized to begin recovering the portion of its water quality litigation memorandum account associated with its defense of water quality litigation for LA Division.

10. San Gabriel should continue to record in its water quality litigation memorandum account, for later evaluation and possible recovery, its defense-related water quality litigation costs and all defense-related amounts received from polluters, insurers, and others.

11. It would be burdensome to San Gabriel, ORA, Water Division and the Commission to prepare, file and process a large number of separate advice letters implementing authorized capital project and payroll expense offset rate increases during the rate case cycle, and the resulting rate changes would be confusing to customers. It would be reasonable for the Commission to limit the number of such advice letters resulting from this order to two per fiscal year.

12. There is a strong likelihood San Gabriel will receive some as-yet-unquantifiable tax benefit from the federal American Jobs Creation Act of 2004. That benefit has not been reflected in the adopted figures for this proceeding.

13. The test year 2005/2006 rates in Attachment B have been designed to produce revenues consistent with the summary of earnings adopted in this order.

14. The potential benefits of full cost balancing accounts for purchased water, pumped water, and purchased power are greatly outweighed by other considerations.

15. San Gabriel's showing of compliance with applicable water quality standards during the past three-year rate case cycle is undisputed. San Gabriel provides adequate water service in LA Division.

Conclusions of Law

1. The agreed outcomes set forth in the All Parties Joint Stipulations and Comparison Exhibit filed by San Gabriel and ORA are not "stipulations" as defined in Rule 51.1. Rather, they are joint recommendations arrived at as a result of each party's having re-examined its earlier conclusions in light of evidence presented by the other.

2. One of the conditions under which the Commission in Resolutions W-4089 and W-4094 authorized San Gabriel and others to establish water quality litigation memorandum accounts was that all expenses associated with the memorandum account must be offset by insurance proceeds and/or proceeds from the polluters before rate relief may be granted.

3. The \$3.5 million BPOU settlement amount constitutes proceeds from the polluters within the meaning of Resolutions W-4089 and W-4094.

4. It would be inequitable and unreasonable to grant San Gabriel's request to recover from ratepayers the litigation costs booked in its water quality litigation memorandum account while allowing San Gabriel to book as shareholder profit proceeds from polluters received for, in part, San Gabriel's granting a waiver of those litigation costs.

5. San Gabriel should be allowed to continue to book its LA Division pursuit-of-contaminators litigation costs into the water quality litigation memorandum account, and required to record as offsetting entries the \$3.5 million BPOU settlement amount at issue here and any similar amounts in the future.

6. The final water quality litigation memorandum account balance associated with pursuit of contaminators should not be adjudicated until most or all of San Gabriel's litigation against polluters in LA Division has been concluded.

7. San Gabriel should collect subject to refund the amount of its adopted revenue requirement that results from our computational assumption that the American Jobs Creation Act of 2004 does not apply, until our order finally establishing in a future proceeding the actual tax benefit, if any, conveyed to San Gabriel under the Act. San Gabriel should report the amount collected and the status of its tax liability under the Act in each general rate case until we have made a final determination.

8. San Gabriel should be authorized to implement the rate changes set forth in this order.

9. The revised rates set forth in Attachment B are justified.

10. This decision should be made effective immediately to allow San Gabriel to put the revised rates into effect as near as possible to the first day of the test year.

O R D E R**IT IS ORDERED** that:

1. San Gabriel Valley Water Company (San Gabriel) is authorized to file in accordance with General Order 96 and make effective on not less than five days' notice revised tariff schedules reflecting the adopted rates for test year 2005/2006 included as Attachment B to this order. The revised tariff schedules shall apply to service rendered on and after the date this decision is mailed.

2. Not later than May 15, 2006 and May 15, 2007, San Gabriel shall file advice letters in conformance with General Order 96 proposing new Los Angeles County Division (LA Division) revenue requirements for escalation years 2006/2007 and 2007/2008 respectively, and corresponding revised tariff schedules. San Gabriel's advice letters shall follow the escalation procedures set forth in the Commission's Rate Case Plan for Class A Water Utilities, and shall include appropriate supporting workpapers. San Gabriel shall adjust the escalation year revenue requirement to the extent its rate of return on rate base for LA Division for the twelve months ending March 31, 2006 and March 31, 2007, taking into account the rates then in effect and normal ratemaking adjustments, differs from the rate of return found reasonable in this order. The revised tariff schedules shall take effect on July 1, 2006 and July 1, 2007, respectively, and shall apply to service rendered on and after their effective dates. The proposed, revised revenue requirement and rates shall be reviewed by the Commission's Water Division. Water Division shall inform the Commission if it finds that the proposed rates do not conform to the Rate Case Plan, this order, or other Commission decisions, in which case all revenues collected under the revised rates shall be subject to refund until the Commission has decided the matter.

3. San Gabriel is authorized to recover by advice letter(s) 80% and 25% respectively of the salaries and pension and benefit costs of one new Water Quality Specialist position and one new Water Treatment Operator III position in LA Division after each of those positions is filled. This authorization is subject to the two advice letter per fiscal year limitation set forth in Ordering Paragraph 11 below.

4. The capital structure, cost of debt, rate of return on equity, and rate of return on rate base shown in Table 2 are adopted for LA Division for the 2005/2006 through 2007/2008 general rate case cycle.

5. The summary of earnings presented in Attachment A, and the quantities and calculations included as Attachment C to this order that underlie it, are adopted.

6. San Gabriel shall credit the \$3.5 million Baldwin Park Operable Unit settlement amount at issue in this proceeding, and any other, similar contamination litigation settlements amounts it has received or will receive in the future that are not designated for capital and operating costs of remediation facilities, to its LA Division water quality litigation memorandum account effective on the date each amount was or is received.

7. San Gabriel's request to amortize the amount in its LA Division water quality litigation memorandum account associated with pursuit of contaminators is denied. That component of the final water quality litigation memorandum account balance will not be adjudicated until most or all of San Gabriel's litigation against polluters in LA Division has been concluded

8. San Gabriel is authorized to file an advice letter to begin recovering the balance as of December 31, 2004 in its water quality litigation memorandum account associated with its defense of water quality litigation for LA Division.

The advice letter shall include proposed tariff sheets and work papers, and shall go into effect upon Water Division's determination that it complies with this decision and the Commission's established procedures for recovering memorandum account balances.

9. San Gabriel shall continue to record in its LA Division water quality litigation memorandum account, for later evaluation and possible recovery, its ongoing defense-related water quality litigation costs and all defense-related amounts received from polluters and insurers.

10. San Gabriel is authorized to recover by advice letter(s) the capital costs of the 16 projects designated as "Advice Letter" in Appendix C to the All Parties Joint Stipulation and Comparison Exhibit included as Attachment E to this order, after each project is completed and placed in service. The project by project cost upon which each offset request is based shall not exceed the Estimated Cost set forth in that Appendix. This authorization is subject to the two advice letter per fiscal year limitation set forth in Ordering Paragraph 11 below.

11. San Gabriel shall file no more than two advice letters during each fiscal year of this general rate case cycle implementing the LA Division payroll expense and capital project offset rate increases authorized in Ordering Paragraphs 3 and 10 of this order. San Gabriel may group multiple completed and in-service plant projects and/or personnel positions into each advice letter, and may time its filings as it sees fit. This limitation does not apply to other advice letter filings authorized by this order.

12. San Gabriel shall collect subject to refund the amount of its adopted revenue requirement that results from our computational assumption that the American Jobs Creation Act of 2004 does not apply, until our order finally establishing in a future proceeding the actual tax benefit, if any, conveyed to

San Gabriel under the Act. San Gabriel shall report the amount so collected and the status of its tax liability under the Act in each general rate case until the Commission has made a final determination.

13. San Gabriel's request to add to its LA Division water quality memorandum account future expenditures related to water quality, as described in the application and discussed in the body of this decision, is denied.

14. San Gabriel's request to convert its LA Division purchased water, pumped water, and purchased power balancing accounts to full cost balancing accounts is denied.

15. San Gabriel is authorized to file an advice letter to begin amortizing the amounts recorded in its purchased water, pumped water, and purchased power balancing accounts as of December 31, 2004, or such later date as San Gabriel and the Commission's Water Division may jointly agree. Amortization in rates shall be subject to the Commission's and Water Division's standard procedures for validating the amounts claimed in such advice letters.

16. San Gabriel's requests in Application (A.) 04-09-005 are granted as set forth above, and in all other respects are denied.

17. A.04-09-005 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

[McVicar Attachment A-E](#)